

REVENUE ESTIMATES

The long-anticipated recovery of California revenues arrived in 2003 and the outlook for 2004 and 2005 is for continued, though moderate, growth. Therefore, the revenue outlook has improved from what was expected at the time the 2003 May Revision was prepared. Since enactment of the 2003 Budget Act, the General Fund revenue forecast for major taxes and licenses has increased by \$1.7 billion for the past and current years combined. In addition, an increase of 4 percent in revenues, or \$2.9 billion, to \$76.4 billion is expected for 2004-05. The revenue increase includes significant gains in the three major taxes: personal income tax, sales tax, and corporation tax.

Improvement in the California economy began late in 2002, with taxable sales showing year-over-year growth beginning in the third quarter of 2002, after four consecutive quarters of negative growth. During 2003, personal income tax withholding also began to show year-over-year growth, after declining nearly every month since mid-2001. Finally, personal income tax estimated payments are expected to recover in 2004, after three years of negative growth.

As has been noted for some time, the State's remarkable revenue growth in the late 1990s was driven by stock market related gains, while the fall-off from 2000 through 2002 largely reflected the market's decline. With regard to market-related income, growth is expected to resume in 2003 and should continue, albeit at more sustainable levels.

Despite the positive developments in the economic and revenue outlook, revenue growth alone will not solve the State's budget problems. Because of the accumulated deficit and the structural



deficit, the Governor's Budget includes major program reductions and restructuring, as described in other sections.

Major Revenue Sources

Personal income tax revenues are projected to be \$35.1 billion in 2003-04 and \$38 billion in 2004-05. Capital gains peaked in 2000 before plunging 57 percent in 2001 and an additional 30 percent in 2002, based on preliminary data. This forecast assumes that the revenue bubble that burst in 2001-02 and 2002-03 is now completely deflated and moderate growth will resume in 2003-04.

Sales and use tax revenue is forecast at \$23.7 billion in 2003-04 and \$25 billion in 2004-05. Taxable sales for 2003 are expected to be up by 2.3 percent compared to 2002. Taxable sales are anticipated to grow at a faster rate in 2004 and 2005 due to the improving economy, increasing by 5.8 percent and 5.4 percent, respectively.

Corporation tax revenues are expected to total \$7.5 billion in 2003-04 and \$7.6 billion in 2004-05. Taxable profits are estimated to increase by 6.7 percent in 2003-04 and 13.2 percent in 2004-05.

The Governor's Budget revenue forecast also reflects the following proposals:

- **Personal Income Tax Integrated Nonfiler Compliance (INC) Program**—The Budget proposes to identify additional taxpayers who do not file tax returns, but owe personal income tax. The proposal is estimated to increase revenues by \$12 million in 2004-05, and \$43 million in 2005-06.
- **Sales Tax on Gasoline**—The sales tax on gasoline and diesel sales is allocated for transportation purposes. A portion of the sales tax on gasoline (and diesel sales) is allocated to the Public Transportation Account (PTA). When gasoline prices are high relative to other sales, the PTA receives the "spillover" sales tax revenues. The Budget proposes to maintain the base level of transfers to the PTA, but specifies that any excess sales tax revenue on gasoline remains in the General Fund, thereby increasing General Fund revenues by \$17.5 million

in 2003-04, above the \$87.5 million expected at the 2003 Budget Act. This is a mid-year spending reduction proposal.

- **Natural Heritage Preservation Tax Credit**—The Budget proposes to suspend the award of credits for two years, 2003-04 and 2004-05, for a General Fund revenue savings of \$8.7 million in 2003-04 and \$10.3 million in 2004-05. This is a mid-year spending reduction proposal.
- **Indian Gaming Revenues**—It is the intent of the Administration to renegotiate tribal gaming compacts with California's 64 tribes that have gaming compacts, and to negotiate new compacts with any additional tribes that wish to commence class III gaming. Part of any such renegotiation will include demands by the State that tribes currently gaming, or those wishing to game, pay a significant share of revenues to the State. Current estimates of annual income to California tribes as a result of gaming operations range between \$3 billion and \$5 billion. The Administration has announced a target State share of such revenues to be 25 percent on an annual basis. While it is uncertain that the Administration will actually receive the State's target revenue percentage as a result of negotiations during calendar year 2004, there clearly will be improved revenue streams to the State from tribal gaming operations during 2004-05. Given that the full State share of 25 percent of tribal revenues may take some time to achieve, the Budget projects \$500 million in additional revenue to the State from tribal gaming operations in 2004-05.

